C. Rate Of Return Adjustments Should Not Be Made In This Proceeding

Several parties suggest that the Commission recognize alleged measurable changes in the cost of capital, principally changes in interest rates, through changes in the earnings bands that give rise to sharing.[28] Sprint asserts there is no need for the Commission to revisit the 11.25% rate of return that is the center of the current no-sharing zone as several parties suggest in their comments.

Sprint recognizes that price cap LECs are not subject to the Part 65 represcription rules. However, the principle of represcription of rate of return is behind the proposals to "retarget" LEC earnings through either one-time adjustments to the PCI or through changes in the sharing zones.

The Commission noted that current methods of prescribing rate of return "reflect a telecommunications industry and a regulatory environment that has changed dramatically" since Part 65 rules were adopted in 1985.[29] The Commission proposed to "begin represcription proceedings only when market indicators show significant changes in the cost of capital that are likely to persist over time."[30] Sprint believes this same policy should govern any changes to rate of return in the price cap context.

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[28] WilTel, Inc. ("WilTel") at 25, CCTA at 6, AT&T at 26, MCI at 29, and International Communications Association ("ICA") at 13.

[29] Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enformance Processes, 7 FCC Rcd. 4688 (1992) at ¶1 (Rate of Return NPRM).

[30] Id. at ¶4.

Sprint supports the Commission's proposal to avoid represcription unless marked changes are expected to persist over time. In Sprint's view, the demon that plagues cost of capital determinations is short-term volatility. For example, the Aa Public Utility Bond rate bottomed out in October of 1993 at 6.89%. In only seven short months the May 1994 rate was 8.24%, an increase of 135 basis points.[31]

Sprint notes that the Aa public bond yield has bottomed out, and is markedly increasing, all during the current price cap period. As a result, of the current upward trajectory of bond returns, Sprint believes rate of return should not be addressed in this proceeding because recent changes in cost of debt have been short-term, and have not proven to "persist over time."

Sprint also asserts that sharing should be eliminated because of its negative impact on productivity and infrastructure investment. The issue of rate of return represcription, either camouflaged as sharing "indexing" or full rate of return represcription, need not be addressed herein because, with removal of sharing, rate of return would not limit LEC earnings.

Sprint notes that the suggested rate of return changes proposed by some parties are flatly inconsistent with recent findings of the Commission concerning rate of return for cable companies.[32] The Commission prescribed a rate of return of

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[31] Moody's Bond Record May 1994.

[32] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision Regulated Cable Service, Report and

11.25% in that proceeding. In many respects, investments in LECs may present more risk than those in cable companies. For example, Merrill Lynch agrees with TCI Chairman John Malone that[33]:

1) RBOCs are extremely vulnerable, especially in their access revenues;

2) Cable can get into telco before telco can get into cable;

3) Telcos have far more to lose than cable;

4) The coming of competition to the local phone business will accelerate, not decelerate, as a result of the breakup of the Bell Atlantic/TCI merger;

5) The cable industry still needs a strong telco partner, but not an RBOC.

Based on this risk alone, LECs may require a higher return than the 11.25% recently prescribed for cable companies.

In the last LEC represcription proceeding the Commission did not accept the LEC position on several critical rate of return related issues. The Commission adopted the Regional Holding Company ("RHC") structure rather than the BOC capital structure "because the capital structure of those entities is subject to manipulation by the holding companies."[34] The Commission adopted a DCF model that it noted may well "understate the RHC cost of equity due to the influence of investor expectations about cellu-

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Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-915, CS Docket No. 94-28, released March 30, 1994, at 109, ¶207.

[33] Merrill Lynch Telecom Services, March 1, 1994 at 1. *See* USTA Reply Comments, Dr. Randall S. Billingsley Attachment at 4-8.

[34] Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, 5 FCC Rcd. 25 (1990) at ¶8.

lar telephone"[35] but it assumed that access service risk was lower than RHC unregulated activities. As the Merrill Lynch Telecom Services report indicates, however, the risk of regulated access services has increased. Thus, the conclusion that the DCF model used in 1990 is appropriate for use in 1993 is highly questionable. The Commission in 1990 also ignored other available models even though it did "not in principle reject" their use.[36]

Faced with this background, MCI and AT&T ask the Commission to lower the rate of return target for price cap LECs. Sprint believes any action in this regard is unjustified. As explained above, nothing of a persistent nature has occurred in the debt markets to cause the Commission to consider this matter further. Indeed, the increase in risk that LECs face may have increased the return requirements. If the Commission examines rate of return, which Sprint does not support, it should once again consider using more accurate DCF analysis, actual LEC capital structure, and alternatives to the flawed DCF analysis used in 1990.

Sprint notes that capital markets are once again undergoing significant short-term volatility. The recent fall of the dollar against the Japanese Yen has been attributed to the expectation of higher inflation in the United States economy. Higher infla-

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[35] Id. at ¶9 and 102. The Commission noted that their 1990 DCF results may be understated by up to 75 basis points because of the inclusion of cellular in the RHC analysis. Sprint believes that the upcoming introduction of PCS auctions make the cellular properties even more valuable and potentially skew the DCF results even more.

[36] Id. at 11.

tion is accompanied by higher interest rates and higher equity return requirements. Because of this recent event, which follows several interest rate increases by the Federal Reserve during the opening months of 1994, DCF analysis based on 1993 data significantly understates the real returns that the market demands.

Thus, even though there is evidence that interest rates declined during the price cap period, the decline did not justify a lower rate of return for cable companies, and with interest rates on the rise, does not appear to justify any action that would change the rate of return prescription for LECs.

Sprint further believes that the Commission's rate of return for LECs does not realistically reflect the real earnings of LECs. Price cap LECs are generally subject to Commission prescribed depreciation schedules that appear to extend the depreciation lives of much of their plant far past the economic life of the plant. Changes in technology have significantly shortened the economic life of much of the LEC plant. However, because Commission accounting procedures require the use of prescribed depreciation, the shortened life of the plant is not recognized in the Commission's rate of return calculations. Thus, the return is overstated based on what the LECs believe to be their actual rate of depreciation of the newer high tech equipment that is currently being installed in the LEC networks.

The Sprint LECs calculated their 1992 and 1993 estimated rates of return using AT&T's depreciation rates. This calcula-

tion resulted in a significant change. The original 1992 Form 492 stated rate of return was 12.75% and using AT&T depreciation rates this return is reduced to 9.21%. The 1993 Form 492 stated rate of return was 14.02% but this is reduced to 9.66% using AT&T depreciation rates.[37]

Further, AT&T and MCI are simply wrong in alleging that the LECs' cost of capital has declined since 1990. The AT&T and MCI rate of return calculations are very similar and, while based on the specific DCF model used by the Commission in 1990, are burdened by similar flaws. In Sprint's view both AT&T and MCI oversimplify the cost of equity estimation process by relying on only one cost of equity method: the discounted cash flow approach. Neither AT&T nor MCI present a risk premium analysis to check, supplement, or evaluate the veracity of their DCF results. The Commission recognized that models other than DCF could be used and Sprint believes that multiple cost of equity methods are appropriately required to guard against the possibility of anomalous results.

Both AT&T and MCI use flawed DCF models that fail to reflect the reality that firms actually pay dividends quarterly and incur expenses when raising equity capital. Both AT&T and MCI apply their flawed DCF models to a proxy group that is inappropriate

[37] A theoretical investor would have complete and perfect information that would automatically discount the worth of an investment in a price cap LEC. However, because its returns are overstated, based on unreasonably long depreciation rates, Sprint does not believe that the stringent theory of market efficiency is fully effective and believes the market does not fully take into account this problem.

for LECs: the Regional Holding companies. Sprint believes that the stability in debt/equity ratios in the LEC industry, including the Sprint LECs, supports use of actual LEC capital structure rather than use of the RHC capital structure. Sprint does not believe that BOC capital structure is unreasonable given the risks they face and does not believe that this capital structure has been "manipulated" for some sinister reason.

Although MCI alleges manipulation of BOC capital structures, its expert provides no supporting evidence.[38] Actually, the available evidence contradicts Mr. Kahal's unsupported assertion. The BOCs have generally structured their capital structures so that they qualify for "A" or "Aa" bond ratings with equity ratios in the high 50% and low 60%s, demonstrating that the BOCs' financial leverage is entirely appropriate for their level of business risk as perceived by the investment community. Further, the use of the BOCs' capital structure and cost of debt has additional advantages when contrasted to the RHC capital structure because it is easily measurable and readily obtainable from the ARMIS 43-02 USOA report data already on file with the Commission.

Sprint believes that the risk component and the DCF analysis should use a group of market-traded firms comparable in risk to the Bell operating companies (BOCs), as determined by appropriate risk measures. The Billingsley report filed by USTA provides an

[38] MCI Comments, Statement of Matthew I. Kahal.

appropriate group of market-traded firms to determine the LECs' cost of equity.[39]

For the foregoing reasons, Sprint believes the Commission should not consider changes to the current 11.25% return prescription.

III. DENSITY ZONE PRICING ANSWERS LEC NEEDS FOR INCREASING PRICING FLEXIBILITY

A. LECs Retain Market Power And Currently Face Little Access Competition

The BOCs and USTA assert that LECs face significant access competition from CAPs, cable companies, IXCs (through self-supply of access facilities), wireless and PCS service providers, and gas and electric utilities.[40] They state that the existence of such pervasive competition warrants increased LEC pricing flexibility, and recommend a restructuring of existing rules based on USTA's IMA/TMA/CMA (initial, transitional, and competitive market areas) model. Among other things, this model allows for removal of services from price cap regulation and provision of such services through contract-based tariffs (i.e., customer-specific pricing); streamlined price cap regulation of services in a TMA; broader IMA pricing bands; exclusion of CMA and TMA demand and prices from price cap index calculations; and relaxation of new service pricing and notice rules.

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[39] *See* USTA Reply Comments, at Billingsley Exhibit 2 5-8 and Exhibit 3.

[40] *See, e.g.*, USTA at pp. 25-40; Ameritech at pp. 8-11 and 29-30; and Bell South at pp. 74-95.

The BOCs' claimed lack of market power is belied by the record evidence, and their requests for relaxed regulatory oversight and additional pricing flexibility should accordingly be rejected. The BOCs retain bottleneck control over exchange access facilities, and what competition may exist is minimal. For example:[41]

-- CAPs account for less than 1% of access revenues and provide dedicated, high capacity services only to approximately 4,000 buildings nationwide. In addition, they have only a minuscule fraction of the plant in service and the number of network employees as do the LECs.

-- Cellular carriers use the LECs' landline networks for virtually all (99%) of their calls, and the price and quality of cellular service today generally compare unfavorably to landline service.

-- PCS services are not yet available and, even when they are, they are likely to rely at least in part on LEC landline networks.

-- Even assuming that cable and utility companies intend to compete with LECs, their facilities would have to be substantially upgraded and expanded, at great expense and time, before they could be used to provide telephone services.

-- There remain substantial legal and regulatory barriers to both local service and exchange access competition, including the lack of local number portability; exclusive local and intrastate franchises granted to the LECs; LECs' favorable municipal franchise agreements

[41] *See, e.g.*, Sprint at pp. 24-26, ALTS at pp. 12-26; AT&T at pp. 9-21; MCI at pp. 64-72, MFS at pp. 37-50; and Teleport at pp. 15-21.

and taxes; and LECs' preferred access to public rights of way.

-- LECs continue to control vital strategic nodes such as the 800 and LIDB databases.

It also should be noted that the U.S. Court of Appeals for the District of Columbia Circuit recently vacated the Commission's physical collocation orders and remanded to the Commission the issue of when virtual collocation should be imposed.[42] This judicial decision casts some doubt as to the efficacy of collocation as a spur to the development of local transport and special access competition. At this time, it is unclear whether the BOCs will make expanded interconnection available to their potential competitors at all, or on what terms and at what rates. Given this uncertainty, the Commission must be doubly cautious in considering LEC requests for additional regulatory flexibility.

Despite the compelling body of evidence showing that the LECs retain overwhelming market power in the provision of local and access services (or perhaps because of it), USTA and the BOCs assert that market share computations and financial and other barriers to entry are irrelevant, and that "addressability"--whether an alternative provider already has facilities that can readily extend service to a customer upon request--is the appropriate standard for determining whether to

[42] *Bell Atlantic Telephone Companies, et al. v. FCC, et al.*, CADC Nos. 92-1619 et al., decided June 10, 1994.

relax LEC regulatory requirements.[43] Market share has long been used as a measure of the degree of competition, and it would seem self-evident that lack of financial resources, customer inertia/brand loyalty to the incumbent LEC, and LEC network economies of scale and scope,[44] all constitute enormous barriers to entry and expansion. Further, as Sprint has demonstrated elsewhere,[45] USTA's market area model is fatally flawed since it would essentially deregulate LEC access pricing before the LECs face competitive alternatives that are ubiquitous, comparable and available in fact as well as in theory.

Even if it were true that LECs face "substantial" competition (which, clearly, is not the case), LECs already enjoy significant pricing flexibility. For example, they are allowed to offer volume and term discounts (which in fact should be subject to much more stringent regulatory requirements to minimize their potentially discriminatory effect), and may price certain of their interstate rates on a density zone basis. If LECs are granted the expanded density zone pricing authority recommended by Sprint[46] they would be able to meet any competitive pressures which may exist today or may develop in the foreseeable future.

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[43] *See, e.g.*, USTA, pp. 58-66. Indeed, Bell South even states (p. 22) that "LECs ought to be afforded the same pricing flexibility that is found in competitive markets irrespective of the level of competition for LEC services." Such a position ignores the serious (potentially fatal) damage from cross-subsidization and discrimination which a dominant carrier can inflict.

[44] LECs have an integrated network used to provide basic local service, intraLATA toll, and intrastate and interstate access services.

[45] Reform of the Interstate Access Charge Rules, RM-8356, comments of Sprint Communications Co. filed November 1, 1993. Sprint incorporates these comments by reference.

[46] Sprint Comments at 9-10 and 26-27.

B. USTA's Access Reform Proposal Is Beyond The Scope Tf This Price Cap Proceeding.

This is a price cap reform proceeding while IMA/TMA/CMA pricing and certain other components of USTA's proposal, such as Part 69 access rule simplification, are significant access reform proposals. Issues of this nature are more properly addressed in an access reform proceeding such as the Ad Hoc access reform petition or the earlier NARUC request for a notice of inquiry.[47] Either of these proceedings is a more appropriate vehicle for considering comprehensive access charge reform.

USTA's "pricing flexibility proposal[48] was previously advanced as a key component of its proposed access reform petition in USTA's Petition for Rulemaking, filed September 17, 1993, in RM-8356, Reform of the Interstate Access Charge Rules. The USTA proposal presents many issues, including market power measurement criteria, that are both extraneous to price cap reform and require substantial debate prior to any form of implementation. The proper place to consider these proposals is in an access reform proceeding.

The instance price cap proceeding is not the place, for example, to consider Bell Atlantic's misplaced claims that high cap

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[47] In the Matter of Amendment of Part 36 and Part 69 of the Commission's Rules to Effect Comprehensive Reform of the Access Charge System, RM 8480. The issues presented in the Ad Hoc petition include: (1) universal service funding, (2) cost-based access charges, (3) emerging access competition, (4) jurisdictional separations, (5) reform of subsidy mechanisms, and (6) de-linking of Parts 36 and 60 and NARUC's Request for a Notice of Inquiry Concerning Access Issues (Public Notice DA 93-847, August 3, 1993).

[48] USTA at 58.

access is fully competitive today.[49] This claim is supported by no market share loss whatsoever, and would, under the USTA framework, cause all hi cap (DS1 and DS3 throughout its multi-state service area) to be declared transitionally or fully competitive, implying that competition in rural Pennsylvania and urban Philadelphia are the same, for example. Clearly these claims are better addressed in an access reform proceeding and should not be considered herein.

C. LECs, At This Time, Do Not Require More Pricing Flexibility Than Density Zone Pricing Would Provide

USTA and the BOCs all claim the need for significant access pricing flexibility for existing services, including the ability to offer large term and volume discounts, customer specific pricing options, price increases and decreases outside the established range without additional cost support, and total abandonment of rate averaging.[50]

Stripped to the barest essentials, these requests all revolve around the need to provide market and cost based prices in areas where competition is most likely to first develop and to

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[49] Bell Atlantic at 21.

[50] *See, e.g., USTA* at 55-72 (remove Part 69 codification of most service elements at 55, remove regulation of CMF services at 70, and allow contract tariffs at 70), Ameritech at 10 (remove competitive services from price cap regulation and supports USTA), Bell South at 8-10 (do away with subindices for services like DS1 and DS3), and US West at 12, 32 (remove competitive services from price cap regulation at 12 and do away with subindices at 32).

The BOCs are seeking significant access pricing flexibility and proposing virtual deregulation of these services while, at the same time, petitioning Congress to remove the MFJ's interexchange prohibition. The MFJ restrictions were placed on BOCs because of previous access abuses. While the BOCs maintain access market power neither deregulation of access nor entry in interexchange markets is appropriate.

deaverage prices to allow this market pricing to happen. The Commission, however, has established a system that prevents this type of deaveraging from occurring until after an actual competitor has requested expanded interconnection.[51] Only when expanded interconnection has been requested may a LEC implement density zone pricing and tailor its prices to fit both the cost and the market dynamics associated with various volumes in similar offices.

Because LECs have been denied the use of the density zone pricing tool until they have actually lost customers, and because of the pricing constraints placed on density zone rates,[52] they have an incentive to resort to other mechanisms to indirectly achieve deaveraging and pricing to fit their vision of the market. However, this indirect deaveraging brings with it significant negative impacts upon both the access market and upon

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[51] Density zone pricing was adopted in Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd. 7369(1992) and 8 FCC Rcd. 127 (1993) as part of the Commission's Expanded Interconnection collocation policy. On June 10, 1994, the United States Court of Appeals for the District of Columbia Circuit overturned the Commission's requirement of expanded interconnection through physical location and remanded the companion virtual collocation decision. *See Supra Note* 42. Teleport filed a Petition for Declaratory Ruling with the Commission on June 10, 1994 asking the Commission to vacate its density zone pricing policy because physical collocation had been vacated by the Court.

Sprint asserts the Commission should continue to support and indeed should expand density zone pricing even though physical collocation has been vacated by the Courts because the lack of density zone pricing authority is driving LECs to propose inappropriate term and volume discounts to meet perceived competition needs. Furthermore, density zone pricing will drive access rates closer to cost even if physical collocation is not available to CAP and other access customers.

[52] *See,* Sprint Communications Company's October 18, 1993 and December 17, 1992 Petition for Reconsideration in CC Docket 91-141.

consumers and has been appropriately and roundly criticized.[53] Sprint agrees with this criticism.

To the BOCs this makes perfect business sense, since AT&T, with its large volumes, represents the greatest potential loss to CAPs. However, by steeply discounting access to AT&T, the BOCs may retain AT&T as a customer, prevent CAP entrance, and still charge the smaller IXCs a higher price than AT&T for the same facilities. This may be accomplished while limiting the degree of risk that the volumes the smaller IXCs offer will attract market entry by CAPs.

The impact of this pricing scheme is to charge AT&T access rates which are lower than those available to other IXCs. This is an inappropriate pricing scheme because AT&T's traffic is carried on the same facilities as that of other IXCs.[54] The economies of scale inherent in the interoffice transmission facilities are the result of the total traffic from all IXCs and the LEC itself. It is inappropriate for the LEC to pass on the economies of scale primarily to AT&T and to deny these benefits to other IXCs. This discriminatory pricing scheme that passes on economies of scale benefits to only one IXC has a negative impact upon

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[53] *See* ,e.g. MFS at 2, 6, and 9 and fn. 5 which supports appropriate deaveraging.

[54] If BOCs are allowed into the interLATA market, which Sprint opposes, the access volume discounts they have created will work to their advantage. Approximately 60% of all interLATA calls originate and terminate within a RBOC region. This high volume in-Region will allow RBOCs to achieve quickly the volume discounts that have been denied all but one IXC and will provide them an unfair competitive advantage.

the IXC market. AT&T is given an unfair cost advantage that provides it additional market power in the IXC market.

While Sprint recommends that the BOCs not receive approval of the virtually unlimited pricing flexibility they have requested here, Sprint enthusiastically supports the grant of immediate cost-based density zone pricing authority for LECs. This level of deaveraging meets the LEC's need to deaverage costs and prices to meet the competition.

While some LECs may argue that additional pricing flexibility beyond density zone pricing is needed, Sprint asserts that is not the case.[55] The cost per circuit of a fiber optic transmission system is primarily dependent on traffic volume. As traffic volume increases the cost per circuit decreases.[56] Thus, a LEC may meet its competitive needs by offering prices to customers in an area that are based on the total traffic volume/cost relationship in each office. If similar volume offices are grouped together in zones, the costs/prices needed to meet the market should be similar and the competitive pressures should be similar. Thus, the need to deaverage to meet the market are sufficiently met through density zone pricing because LECs may price to the market. Further, the problems with customer-specific

[55] The Sprint LEC serving area includes several major metropolitan areas, not unlike that seen in the territory of a RBOC, including Las Vegas as well as portions of suburban Chicago and Orlando. Even so, the Sprint LECs are confident that they could meet the competitive threats through an access charge system that enabled the immediate and nondiscriminatory implementation of density zone deaveraging.

[56] *See*, United Telephone Comments, CC Docket No. 91-141 filed August 6, 1991 at 16-22, and November 5, 1991 at 1-7.

pricing, discriminatory volume discounts, and unneeded IXC market distortions are avoided. Sprint urges the prompt adoption of density zone pricing for all LECs as the preferred method of providing appropriate pricing flexibility for LECs so that they may fairly deal with competition.[57]

D. The Tariff Review Period Should Not Be Changed

The BOCs and USTA seek the pricing flexibility afforded them by removal of tariff filing review periods before tariffs become effective.[58] Sprint also opposes these proposals.

The opportunity for LEC customers to review proposed tariffs is an important check on inappropriate LEC pricing initiatives. If the review period is shortened from the current 45 days to a mere 14 days as has been proposed by many LECs, customers will not have sufficient time to review filings and prepare an effective protest if irregularities are found. During a time when many complex filings are made and analytical resources are stretched very thin, 14 days' notice simply does not provide sufficient time needed to analyze proposed LEC tariff changes.

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[57] Sprint notes that AT&T opposes further implementation of density zone pricing. See AT&T at 44. Sprint believes that AT&T in reality opposes zone density pricing because AT&T would no longer be able to be the only IXC that benefits from deaveraging in LEC offices. As explained earlier, AT&T is often the only IXC to benefit from customer specific pricing and volume discounts developed specifically to keep it from considering any move to a CAP. If zone density pricing were adopted, all IXCs receiving service from an office would share in the benefits of deaveraging to that office. Because AT&T would lose part of its artificial cost advantage caused by LEC discriminatory volume discounts under a zone density pricing system, Sprint believes AT&T opposes further adoption of zone density pricing.

[58] *See, e.g.*, Bell Atlantic at 23 and USTA at 72.

E. The New Services Test Should Not Be Eliminated

It is inappropriate to exclude new services from tariff or price cap review or abandon Part 69 as some BOCs and USTA seek.[59] In many if not most cases, the so-called "new" services proposed by BOCs are simply replacements or extensions of existing services. Thus, the pricing relationship between current services and new services is critical to ensure that new services are not inappropriately migrating customers from one service to another based on inappropriate pricing and cost relationships.

IV. ALLOCATION OF OVERHEADS IN A UNIFORM ACROSS-THE-BOARD FASHION FOR ALL SERVICES SHOULD BE REJECTED

WilTel argues that the Commission should require uniform overhead allocations across all price cap services in order to assure non-discriminatory pricing.[60] Sprint believes WilTel's proposal, though well-intentioned, must be rejected. To Sprint's knowledge, the Commission, even in the heyday of rate of return regulation, has never required a carrier to employ precisely uniform allocations of overheads for all services. Moreover, the Part 69 access rules contain several different methods for assigning overhead costs to various rate elements rather than employing a simple across-the-board allocation.[61] Finally, this proposal could create a pricing umbrella under which LEC competitors could price, thus providing them an inappropriate competi-

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59 *Id.*

60 Wiltel at 31-32.

61 *See*, Subpart E of Part 69.

tive advantage and sending inappropriate market signals that would encourage uneconomic investment.

Any scheme that requires identical margins on each product would require annual repricing of all services. The cost of telecommunications services depends on the volume of the service consumed. As volumes change among products that utilize some common inputs, as they will from year to year, the cost will change among products. This will result in changes in all prices based on recalculated costs. Sprint believes it unreasonable to require all prices to be changed on an annual basis simply because the volume/cost relationship between services has changed. Rather than expend the tremendous amount of work required and disrupt established customer pricing, Sprint believes prices should generally be left to the discretion of LECs within established price cap pricing guidelines. Under these guidelines, LECs may retain many of their prices from year to year and change only those most in need of change in response to perceived competitive pressures and the overall PCI.

Nonetheless, there may be situations in which closer Commission oversight of overhead allocations is entirely appropriate. For example, Sprint supported continuation of the current "new services" test[62] which requires, inter alia, that the LEC either demonstrate that the overhead allocation for the new service is identical to the overheads allocated to rates for related serv-

[62] Sprint at 20-21.

ices, or provide justification as to why a non-uniform allocation is appropriate. Similarly, where rate relationships between particular service offerings or rate elements raise serious competitive and public interest issues, it may be appropriate to require prescription of cost-based rate relationships on a case-by-case basis. Sprint has shown that in order to fulfill the Commission's policy objectives for local transport rates, the Commission should prescribe, on an ongoing basis, cost-rated rate relationships between direct-trunked transport and tandem-switched transmission rates, as well as between DS3 and DS1 rates for direct-trunked transport.[63] Sprint believes that such case-by case consideration of rate relationship issues is preferable to an inflexible rule that overheads must always be uniformly allocated to all LEC service offerings.

V. CONCLUSION

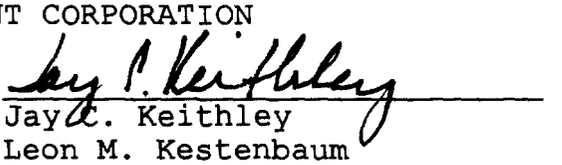
For the valid public policy and procompetitive reasons set forth above, Sprint requests that the Commission adopt the recom-

[63] *See e.g.*, Sprint Communications Co.'s April 4, 1994 Petition for Reconsideration in CC Docket No. 91-213 and its earlier petitions for reconsideration cited therein.

mendations for revisions to LEC price cap regulation supported herein and in Sprint's initial comments.

Respectfully submitted,

SPRINT CORPORATION

By 

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June 29, 1994

CERTIFICATE OF SERVICE

I, Melinda L. Mills, hereby certify that I have on this 29th day of June, 1994, sent via U.S. First Class Mail, postage prepaid, or Hand Delivery, a copy of the foregoing "Reply Comments of Sprint Corporation" in the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1 filed this date with the Acting Secretary, Federal Communications Commission, to the persons on the attached service list.

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